THE MIRIAM HOSPITAL

Financial Statements

September 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

THE MIRIAM HOSPITAL

Statements of Financial Position

September 30, 2006 and 2005

(In thousands)

Assets	2006	2005
Current assets:		
Cash and cash equivalents	$ 17,800	$ 35,735
Patient accounts receivable	41,646	36,956
Less allowance for doubtful accounts	(9,375)	(9,225)
Net patient accounts receivable	32,271	27,731
Other receivables	3,092	2,778
Total receivables	35,363	30,509
Assets limited as to use	6	717
Inventories	3,116	2,714
Prepaid expenses and other current assets	322	201
Total current assets	56,607	69,876
Interest in net assets of The Miriam Hospital Foundation	51,902	48,054
Assets limited as to use	106,087	96,317
Less amount required to meet current obligations	(6)	(717)
Noncurrent assets limited as to use	106,081	95,600
Property and equipment, net	117,060	82,280
Other assets:		
Deferred financing costs, net	1,617	1,239
Other noncurrent assets	684	1,166
Total other assets	2,301	2,405
Total assets	$ 333,951	$ 298,215

Liabilities and Net Assets	2006	2005
Current liabilities:		
Accounts payable	$ 14,350	$ 7,206
Accrued employee benefits and compensation	16,025	14,012
Other accrued expenses	2,855	2,713
Current portion of long-term debt	1,222	1,157
Current portion of estimated third-party payor settlements	14,435	13,124
Estimated health care benefit self-insurance costs	1,508	1,489
Total current liabilities	50,395	39,701
Long-term debt, net of current portion	52,140	50,355
Estimated third-party payor settlements, net of current portion	17,340	12,376
Other liabilities	6,279	5,859
Total liabilities	126,154	108,291
Net assets:		
Unrestricted	176,089	163,730
Temporarily restricted	25,515	20,380
Permanently restricted	6,193	5,814
Total net assets	207,797	189,924
Total liabilities and net assets	$ 333,951	$ 298,215

See accompanying notes to financial statements.

THE MIRIAM HOSPITAL

Statements of Operations and Changes in Net Assets

Years ended September 30, 2006 and 2005

(In thousands)

	2006	2005
Unrestricted revenues and other support:		
Net patient service revenue	$ 269,651	$ 267,089
Other revenue	13,316	13,034
Endowment earnings contributed toward community benefit	613	512
Net assets released from restrictions used for operations	1,139	1,027
Net assets released from restrictions used for research	19,595	21,520
Total unrestricted revenues and other support	304,314	303,182
Operating expenses:		
Compensation and benefits	149,726	140,896
Supplies and other expenses	80,919	82,732
Purchased services	34,197	32,271
Provision for bad debts	15,786	19,492
Depreciation and amortization	8,057	7,978
Interest	2,715	3,083
License fees	8,115	6,623
Total operating expenses	299,515	293,075
Income from operations	4,799	10,107
Nonoperating gains and losses:		
Net realized gains on sales of investments	5,639	4,579
Loss on advance refunding of debt	(3,673)	—
Other nonoperating gains	3	26
Total nonoperating gains, net	1,969	4,605
Excess of revenues over expenses	$ 6,768	$ 14,712

(Continued)

THE MIRIAM HOSPITAL

Statements of Cash Flows

Years ended September 30, 2006 and 2005

(In thousands)

	2006	2005
Cash flows from operating activities:		
Increase in net assets	$ 17,873	$ 27,952
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Loss on advance refunding of debt	3,673	—
Cumulative effect to October 1, 2005 of change in accounting principle for conditional asset retirement obligations	211	—
Net realized and unrealized gains on investments	(5,646)	(7,907)
Change in undistributed portion of interest in net assets of The Miriam Hospital Foundation	(3,848)	(3,011)
Transfers from The Miriam Hospital Foundation	(3,626)	(4,142)
Temporarily restricted gifts, grants and bequests	(23,889)	(24,864)
Depreciation and amortization	8,057	7,978
Provision for estimated health care benefit self-insurance costs	16,728	14,308
Decrease in liabilities for estimated health care benefit self-insurance costs resulting from claims paid	(16,709)	(13,977)
Net (increase) decrease in patient accounts receivable	(4,540)	423
Increase in accounts payable	7,144	493
Increase in accrued employee benefits and compensation	2,013	1,881
Increase (decrease) in other accrued expenses	86	(271)
Increase in estimated third-party payor settlements	6,275	5,314
(Increase) decrease in all other current and noncurrent assets	(885)	1,358
Increase (decrease) in other liabilities	235	(537)
Net cash provided by operating activities	3,152	4,998
Cash flows from investing activities:		
Purchase of property and equipment	(42,727)	(16,320)
Net decrease in trustee-held bond funds	1,755	8
Other net increases in assets limited as to use	(5,879)	(4,213)
Net cash used in investing activities	(46,851)	(20,525)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	40,725	—
Payments to defease refunded bonds	(41,319)	—
Payments on long-term debt	(1,157)	(1,096)
Temporarily restricted gifts, grants and bequests	23,889	24,864
Transfers from The Miriam Hospital Foundation	3,626	4,142
Net cash provided by financing activities	25,764	27,910
Net (decrease) increase in cash and cash equivalents	(17,935)	12,383
Cash and cash equivalents, beginning of year	35,735	23,352
Cash and cash equivalents, end of year	$ 17,800	$ 35,735
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 2,681	$ 3,090

See accompanying notes to financial statements.

(1) Description of Organization and Summary of Significant Accounting Policies

(a) Organization

The Miriam Hospital (the Hospital), located in Providence, Rhode Island, is a 247-bed nonprofit general acute care teaching hospital with university affiliation providing a comprehensive range of diagnostic and therapeutic services (excluding obstetrics) for the acute care of patients principally from Rhode Island and southeastern Massachusetts. As a complement to its role in service and education, the Hospital actively supports research. The Hospital is accredited by the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) and participates as a provider primarily in Medicare, Blue Cross and Medicaid programs. The Hospital is also a member of Voluntary Hospitals of America, Inc. (VHA).

Effective August 9, 1994, the Federal Trade Commission and the Health Services Council of the Rhode Island Department of Health approved the combination of the Hospital and Rhode Island Hospital (RIH) of Providence, RI (719 beds) under a plan which included the creation of a not-for-profit parent company, Lifespan Corporation (Lifespan). Each hospital continues to maintain its own identity and Board of Trustees, as well as its own campus and its own name. Lifespan has the responsibility for strategic planning and initiatives, capital and operating budgets, and overall governance of the consolidated organization. The transaction was accounted for as a pooling of interests at the Lifespan level.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid debt instruments with maturities of three months or less when purchased, excluding amounts limited as to use by board-designation or other arrangements under trust agreements.

(1) Description of Organization and Summary of Significant Accounting Policies (continued)

(d) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statements of financial position. Investments in collective investment funds are measured based on the fair value of the underlying investments. Investments of 5% or more in limited partnerships, limited liability corporations or similar investments are accounted for at fair value, with changes in fair value recorded as realized gains or losses using the equity method. Investments in derivative financial instruments are not material.

Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments other than those accounted for using the equity method are excluded from the excess of revenues over expenses.

Realized gains or losses on sales of investments are determined by the average cost method. Realized gains or losses on unrestricted investments are recorded as nonoperating gains or losses; realized gains or losses on restricted investments are recorded as an addition to or deduction from the appropriate restricted net assets. A decline in the market value of an investment security below its cost that is designated to be other than temporary is recognized through an impairment charge classified as a realized loss and a new cost basis is established.

Investment income from trustee-held funds under bond indenture agreements is recorded as other revenue. Lifespan maintains a spending policy for certain board-designated funds of its patient care affiliates which provides that investment income from such funds is recorded within unrestricted revenues as endowment earnings contributed toward community benefit.

(e) Assets Limited As To Use

Assets limited as to use primarily include assets set aside by the Hospital's Board for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, and assets whose use by the Hospital has been limited by grantors or donors to a specific purpose, as well as trustee-held funds under bond indenture agreements. Amounts required to meet current liabilities of the Hospital are reported in current assets in the statements of financial position.

(1) Description of Organization and Summary of Significant Accounting Policies (continued)

(f) Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is computed over the estimated useful life of each class of depreciable asset using the straight-line method. Buildings and improvements lives range from 5 to 40 years and equipment from 3 to 20 years.

(g) Deferred Financing Costs

Deferred financing costs, which relate to the issuance of long-term bonds payable to the Rhode Island Health and Educational Building Corporation (RIHEBC), are being amortized ratably over the periods the bonds are outstanding.

(h) Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by grantors or donors to a specific purpose, including research activities.

(i) Excess of Revenues Over Expenses

The statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, net assets released from restrictions used for purchase of property and equipment, the cumulative effect of change in accounting principle for conditional asset retirement obligations and the change in interest in net assets of The Miriam Hospital Foundation.

(j) Net Patient Service Revenue

The Hospital provides care to patients under Medicare, Medicaid, managed care and commercial insurance contractual arrangements. The Hospital has agreements with many third-party payors that provide for payments to the Hospital at amounts less than its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with some third-party payors.

Medicare utilizes a prospective payment system for most inpatient hospital services rendered to Medicare program beneficiaries based on the classification of each case into a diagnostic-related group (DRG). Medicare outpatient hospital services are primarily paid using an ambulatory payment classification system.

(1) Description of Organization and Summary of Significant Accounting Policies (continued)

Most hospital services to Rhode Island Medicaid patients are reimbursed based on negotiated costs under a prospective cost arrangement. The tentative hospital reimbursement rates are determined by certain negotiated budgeted expenditures and budgeted volume. Variances from budgeted volume are reimbursable at rates which may differ from the budgeted rate.

The majority of payments from managed care and commercial insurance companies are based upon negotiated fixed pricing arrangements, whereby a combination of per diem rates and specific case rates are utilized for inpatient services, along with fixed fees applicable to outpatient services.

Settlements and adjustments arising under reimbursement arrangements with some third-party payors, primarily Medicare, Medicaid and Blue Cross, are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Hospital has classified a portion of accrued estimated third-party payor settlements as long-term because such amounts, by their nature or by virtue of regulation or legislation, will not be paid within one year. Changes in the Medicare and Medicaid programs, such as the reduction of reimbursement, could have an adverse impact on the Hospital.

(k) Provision for Bad Debts

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements. Additions to the allowance for doubtful accounts are made by means of the provision for bad debts. Accounts deemed uncollectible are deducted from the allowance and subsequent recoveries are added. The amount of the provision for bad debts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental health care coverage and other collection indicators.

(l) Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

(1) Description of Organization and Summary of Significant Accounting Policies (continued)

(m) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. The gifts are reported as temporarily restricted support that increases the net asset class if they are received with stipulations that limit the use of the assets. When a donor or grantor restriction expires, that is, when a stipulated purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions.

(n) Inventories

Inventories, consisting primarily of medical/surgical supplies and pharmaceuticals, are stated at the lower of cost or market.

(o) Estimated Self-Insurance Costs

The Hospital participates in Lifespan self-insurance programs with other Lifespan affiliates for losses arising from medical malpractice claims, health benefits to its employees, and effective August 1, 2006, losses arising from workers' compensation claims. The Hospital has recorded provisions for estimated claims, which are based on Lifespan's own experience. The provisions for self-insured losses include estimates of the ultimate costs for both reported claims and claims incurred but not yet reported.

(p) Fair Value of Financial Instruments

The carrying amounts recorded in the statements of financial position for cash and cash equivalents, patient accounts receivable, assets limited as to use, accounts payable, accrued expenses, estimated third-party payor settlements, and estimated health care benefit self-insurance costs approximate their respective fair values. The estimated fair value of the Hospital's long-term debt is disclosed in Note 10.

(q) Reclassifications

Certain 2005 amounts have been reclassified to conform with the 2006 reporting format.

(2) Cumulative Effect of Change in Accounting Principle

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47 (FIN 47), "Accounting for Conditional Asset Retirement Obligations". Under FIN 47, costs related to legal obligations to perform certain activities in connection with the retirement, disposal, or abandonment of assets are required to be accrued. The Hospital adopted the provisions of FIN 47 effective October 1, 2005.

The Hospital has identified asbestos abatement as a conditional asset retirement obligation. Asbestos abatement costs were estimated based on relevant facts and circumstances. At September 30, 2006, the Hospital recorded site improvements of $96, related accumulated depreciation of $66, asset retirement obligations of $56 and $185 included in other accrued expenses and other liabilities, respectively, and a cumulative effect of change in accounting principle to October 1, 2005 of $211.

(3) Disproportionate Share

The Hospital is a participant in the State of Rhode Island's Disproportionate Share Program, established in 1995 to assist hospitals which provide a disproportionate amount of uncompensated care. Under the program, Rhode Island hospitals, including the Hospital, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. Total payments to the Hospital under the Disproportionate Share Program aggregated $7,655 and $6,015 in 2006 and 2005, respectively, and are reflected as part of net patient service revenue in the accompanying statements of operations and changes in net assets.

The State of Rhode Island has assessed a license fee to all Rhode Island hospitals, based on each hospital's 2004 net patient service revenue as defined. The Hospital's license fee expense was $8,115 and $6,623 in 2006 and 2005, respectively. The hospitals in the State of Rhode Island accepted the fee as part of an agreement with the State's Department of Health and Human Services in return for an equitable distribution of funds to those hospitals meeting certain criteria in providing services to the Medicaid population.

For periods beyond 2006, the federal government could change the level of federal matching funds for the Disproportionate Share Program. Accordingly, it may be necessary for the State of Rhode Island to modify the program and the reimbursement to Rhode Island hospitals under the program. At this time, the scope of such modifications or their effect on the Hospital cannot be reasonably determined.

(In thousands)

(4) Charity Care and Community Services

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy and the estimated cost of those services and supplies.

The following information measures the level of charity care provided by the Hospital during the years ended September 30:

	2006	2005
Charges forgone, based on established rates	$ 17,228	$ 12,383
Estimated costs and expenses incurred to provide charity care	$ 4,815	$ 3,457

The Hospital also provides numerous other services to the community for which charges are not generated. These services include certain emergency services, community health screenings, health/medical education, patient advocacy, foreign language translation and physician referral services.

The Hospital subsidizes the cost of treating patients who receive government assistance where reimbursement is below cost.

Administrative uncompensated care, based on charges, amounted to $2,735 and $2,972 in 2006 and 2005, respectively. The related cost of such care approximated $764 and $830 in 2006 and 2005, respectively.

In addition to the cost of charity care and other community service programs, the Hospital provided $15,786 and $19,492 for uncollectible patient accounts, based on charges net of contractual allowances, during the years ended September 30, 2006 and 2005, respectively. The cost associated with such provisions approximated $4,412 and $5,442 in 2006 and 2005, respectively.

(In thousands)

(5) Investments

The composition of assets limited as to use at September 30, 2006 and 2005 is set forth in the following table.

	2006	2005
Internally board-designated:		
U.S. government and agency obligations	$ 3,073	$ 3,955
Corporate equity securities	25,583	24,977
Corporate obligations	5,532	5,481
Collective investment funds	55,786	47,575
	89,974	81,988
Held by trustee under bond indenture agreements:		
Cash and short-term investments	7	723
U.S. government and agency obligations	442	905
Corporate obligations	—	576
	449	2,204
Temporarily restricted funds:		
Collective investment funds	15,664	12,125
Total	$ 106,087	$ 96,317

(In thousands)

(5) Investments (continued)

Investment income, gains and losses for cash equivalents and assets limited as to use are comprised of the following for the years ended September 30:

	2006	2005
Other revenue:		
Investment income	$ 2,698	$ 2,277
Endowment earnings contributed toward community benefit:		
Dividend and interest income	$ 613	$ 512
Nonoperating gains and losses:		
Net realized gains on sales of investments	$ 5,639	$ 4,579
Other changes in unrestricted net assets:		
Net unrealized gains on investments	$ 112	$ 3,487
Changes in temporarily restricted net assets:		
Income from restricted investments	$ 680	$ 442
Net unrealized losses on investments	(105)	(159)
	$ 575	$ 283

The following criteria are considered in determining other than temporary declines in the fair market value of individual investments:

- The unrealized loss must be present for at least a nine-month period, with a fair market value/cost ratio of less than 75% at both the beginning and end of the period.
- Investments with a fair market value/cost ratio of 25% or less are written down immediately.
- Investments for which the manager has increased the position by at least 20% in the last nine months are not adjusted unless the fair market value/cost ratio is 25% or less; otherwise, these investments are monitored for possible adjustment in future periods.
- Investments whose fair market value/cost ratio is below 75% at the beginning of a nine-month period but above 65% at the end of said period are not adjusted but rather monitored for possible adjustment in future periods.

(In thousands)

(5) Investments (continued)

Information regarding investments with unrealized losses at September 30, 2006 and 2005 is presented below, segregated between those that have been in a continuous unrealized loss position for less than twelve months and those that have been in a continuous unrealized loss position for twelve or more months:

	Less than 12 months		12 months or longer		Total	
September 30, 2006:	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Internally board-designated funds:						
U.S. government and agency obligations	$ 1,337	$ 7	$ 1,416	$ 46	$ 2,753	$ 53
Corporate obligations	788	11	1,134	46	1 922	57
Total debt securities	2,125	18	2,550	92	4,675	110
Corporate equity securities	2,131	301	1,003	156	3,134	457
Collective investment funds	4,172	269	329	31	4,501	300
Total temporarily impaired securities	$ 8,428	$ 588	$ 3,882	$ 279	$ 12,310	$ 867

	Less than 12 months		12 months or longer		Total	
September 30, 2005:	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Internally board-designated funds:						
U.S. government and agency obligations	$ 4,912	$ 89	$ 392	$ 15	$ 5,304	$ 104
Corporate obligations	2,430	57	400	13	2,830	70
Total debt securities	7,342	146	792	28	8,134	174
Corporate equity securities	3,161	323	1,010	224	4,171	547
Total temporarily impaired securities	$ 10,503	$ 469	$ 1,802	$ 252	$ 12,305	$ 721

(In thousands)

(5) Investments (continued)

The following table sets forth changes in internally board-designated investments for the years ended September 30, 2006 and 2005:

	2006	2005
Internally board-designated investments at beginning of year	$ 81,988	$ 71,891
Investment income:		
Dividend and interest income	2,235	2,031
Net realized gains on sales of securities	5,639	4,579
Net unrealized gains on investments	112	3,487
Internally board-designated investments at end of year	$ 89,974	$ 81,988

(6) Property and Equipment

Property and equipment, by major category, is as follows at September 30:

	2006	2005
Land and improvements	$ 4,711	$ 4,711
Buildings and improvements	81,303	78,907
Equipment	100,401	94,797
	186,415	178,415
Less accumulated depreciation and amortization	119,615	111,675
	66,800	66,740
Construction in progress	50,260	15,540
Property and equipment, net	$ 117,060	$ 82,280

Depreciation and amortization expense for the years ended September 30, 2006 and 2005 amounted to $8,057 and $7,978, respectively.

The estimated additional cost of completion of construction in progress approximated $23,793 at September 30, 2006, comprised mainly of various building renovation projects. In addition, the Hospital has several building renovation projects pending contractual commitments with an estimated cost of completion of $9,239.

(6) Property and Equipment (continued)

It is the Hospital's policy to capitalize the net amount of interest cost associated with significant capital additions as a component of the cost of such assets, which is amortized over the asset's estimated useful life. No interest was capitalized in 2006 and 2005.

(7) Pension and Other Postretirement Benefits

Pension Benefits

Lifespan Corp. sponsors the Lifespan Corporation Retirement Plan (the Plan), which was established effective January 1, 1996 when the Rhode Island Hospital Retirement Plan merged into The Miriam Hospital Retirement Plan (the TMH Plan). Upon completion of the merger, the new plan was renamed and is governed by provisions of the Lifespan Corporation Retirement Plan. Each employee who was a participant in the TMH Plan and was an eligible employee on January 1, 1996 continues to be a participant on and after January 1, 1996, subject to the provisions of the Plan. Employees are included in the Plan on the first of the month which is the later of their first anniversary of employment and the attainment of age 18.

The Plan is intended to constitute a plan described in Section 414(k) of the Internal Revenue Code, under which benefits are derived from employer contributions based on the separate account balances of participants in addition to the defined benefits provided under the Plan, which are based on an employee's years of credited service and annual compensation. Lifespan's funding policy is to contribute amounts to the Plan sufficient to meet minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as may be determined to be appropriate by Lifespan.

Substantially all employees of Lifespan Corporation who meet the above requirements are eligible to participate in the Plan. Lifespan uses a measurement date of June 30 for the Plan.

(In thousands)

(7) Pension and Other Postretirement Benefits (continued)

Benefit Obligations

	2006	2005
Change in benefit obligation:		
Benefit obligation, beginning of year	$ 363,010	$ 303,766
Service cost	21,198	17,743
Interest cost	19,495	19,607
Benefits paid	(16,701)	(14,310)
Administrative expenses	(1,065)	(1,092)
Actuarial (gain) loss	(37,825)	37,296
Projected benefit obligation at end of year	$ 348,112	$ 363,010

The accumulated benefit obligation at the end of 2006 and 2005 was $300,221 and $306,904, respectively.

The following assumptions were used to determine end of year benefit obligations:

	2006	2005
Weighted-average discount rate	6.25%	5.0%
Rate of increase in future compensation levels	4.5%	4.5%

Plan Assets

	2006	2005
Change in plan assets:		
Fair value of plan assets, beginning of year	$ 265,119	$ 241,427
Actual return on plan assets	32,251	22,857
Employer contributions	18,512	16,237
Administrative expenses	(1,065)	(1,092)
Benefits paid	(16,701)	(14,310)
Fair value of plan assets, end of year	$ 298,116	$ 265,119

Employer contributions and benefits paid in the above table include only those amounts contributed directly to or paid directly from Plan assets.

(In thousands)

(7) Pension and Other Postretirement Benefits (continued)

The asset allocation for the Plan at June 30, 2006 and 2005, and the target allocation for 2007, by asset category, are as follows:

Asset Category	Target Allocation 2007	Percentage of Plan Assets at June 30 2006	2005
U.S. equity	25-40%	23.4%	26.7%
Absolute return	0-15%	9.9%	7.9%
International equity	10-30%	26.1%	22.9%
Venture capital	0-10%	1.8%	1.8%
Commodities	0-10%	11.5%	10.1%
Real estate	0-15%	8.6%	8.0%
Fixed income	15-35%	18.7%	19.5%
Cash and cash equivalents	0-10%	—	3.1%
Total		100.0%	100.0%

The above table does not include $56,033 and $48,676 of Plan assets at June 30, 2006 and 2005, respectively, attributable to the separate savings account balances of participants which are managed in various mutual funds by Fidelity Investments.

The overall financial objective of the Plan is to meet present and future obligations to beneficiaries, while minimizing long-term contributions to the Plan (by earning an adequate return on Plan assets), with moderate volatility in year-to-year contribution levels.

The primary investment objective of the Plan is to provide a satisfactory return on investment in support of the above objective. The Plan's specific investment objective is to attain an average annual real total return (net of investment management fees) of at least 5% over the long term (rolling five-year periods). Real total return is the sum of capital appreciation (or loss) and current income (dividends and interest) adjusted for inflation by the Consumer Price Index.

(In thousands)

(7) Pension and Other Postretirement Benefits (continued)

Funded Status

The funded status of the Plan, reconciled to the amount reported on Lifespan's consolidated statements of financial position, follows:

	2006	2005
Fair value of plan assets	$ 298,116	$ 265,119
Benefit obligations	348,112	363,010
Funded status	(49,996)	(97,891)
Unrecognized net loss from past experience different from that assumed	8,733	62,506
Prior service cost not yet recognized in net periodic pension cost	5,693	6,693
Net pension liability recognized in Lifespan's consolidated statements of financial position	$ (35,570)	$ (28,692)
Net pension liability recognized in the Hospital's statements of financial position	$ (8,317)	$ (6,741)

The net pension liability recognized in the Hospital's statements of financial position at September 30, 2006 and 2005 consists of:

	2006	2005
Current (included in accrued employee benefits and compensation)	$ 4,410	$ 3,319
Noncurrent (included in other liabilities)	3,907	3,422
Total	$ 8,317	$ 6,741

(In thousands)

(7) Pension and Other Postretirement Benefits (continued)

At the end of 2006 and 2005, the projected benefit obligation, accumulated benefit obligation, and fair value of plan assets were as follows:

	2006	2005
Projected benefit obligation	$ 348,112	$ 363,010
Accumulated benefit obligation	300,221	306,904
Fair value of plan assets	298,116	265,119

Expected Cash Flows

Information about the expected cash flows for the Plan follows:

Employer contributions:	
2007 (expected)	$ 24,990
Expected benefit payments:	
2007	$ 17,400
2008	18,300
2009	20,200
2010	20,700
2011	23,100
2012-2016	146,800

Management evaluates its Plan assumptions annually and the expected contribution in 2007 could increase.

(In thousands)

(7) Pension and Other Postretirement Benefits (continued)

Net Periodic Pension Cost

Components of net periodic pension cost are as follows for the years ended September 30:

	2006	2005
Service cost	$ 21,198	$ 17,743
Interest cost	19,495	19,607
Expected return on plan assets	(20,766)	(18,922)
Net amortization and deferral	5,463	3,103
Net periodic pension cost for Lifespan	$ 25,390	$ 21,531
Net periodic pension cost for the Hospital	$ 5,080	$ 4,117

The following assumptions were used to determine net periodic pension cost:

	2006	2005
Weighted-average discount rate	5.0%	6.25%
Expected long-term rate of return on plan assets	8.0%	8.0%
Rate of increase in future compensation levels	4.5%	4.5%

Lifespan employs a rigorous process to annually determine the expected long-term rate of return on Plan assets which is only changed based on significant shifts in economic and financial market conditions. These estimates are primarily driven by actual historical asset-class returns along with our long-term outlook for a globally diversified portfolio. Asset allocations are regularly updated based on evaluations of future market returns for each asset class.

Other Postretirement Benefits

In addition to providing pension benefits, the Hospital provides certain health care benefits for retired employees. Under Statement of Financial Accounting Standards No. 106, the cost of postretirement benefits other than pensions must be recognized on an accrual basis as employees perform services to earn the benefits.

(In thousands)

(7) Pension and Other Postretirement Benefits (continued)

Benefit Obligations

	2006	2005
Change in benefit obligation:		
Benefit obligation, beginning of year	$ 774	$ 2,824
Service cost	—	111
Interest cost	38	117
Benefits paid	(61)	(47)
Actuarial gain	(208)	(350)
Plan amendment	—	(1,881)
Benefit obligation, end of year	$ 543	$ 774

The following assumptions were used to determine end of year benefit obligations:

	2006	2005
Weighted-average discount rate	6.25%	5.0%

Funded Status

The Hospital has never funded its postretirement benefit obligations. The funded status of the postretirement benefit plan, reconciled to the amount reported on the statements of financial position, follows:

	2006	2005
Benefit obligations	$ 543	$ 774
Funded status	(543)	(774)
Unrecognized net loss from past experience different from that assumed	459	756
Prior service benefit not yet recognized in net periodic postretirement benefit cost	(1,641)	(1,845)
Accrued postretirement benefit cost recognized in the statements of financial position	$ (1,725)	$ (1,863)

(In thousands)

(7) Pension and Other Postretirement Benefits (continued)

The accrued postretirement benefit cost recognized in the statements of financial position at September 30, 2006 and 2005 consists of:

	2006	2005
Current (included in accrued employee benefits and compensation)	$ 61	$ 37
Noncurrent (included in other liabilities)	1,664	1,826
Total	$ 1,725	$ 1,863

Expected Cash Flows

Information about the expected cash flows for the postretirement benefit plan follows:

Expected benefit payments:	
2007	$ 67
2008	71
2009	80
2010	85
2011	98
2012-2016	556

Net Periodic Postretirement Benefit Cost

Components of net periodic postretirement benefit (income) cost are as follows for the years ended September 30:

	2006	2005
Service cost	$ —	$ 111
Interest cost	38	117
Amortization of prior service benefit	(204)	(204)
Amortization of actuarial loss	88	76
Net periodic postretirement benefit (income) cost	$ (78)	$ 100

(In thousands)

(7) Pension and Other Postretirement Benefits (continued)

The following assumptions were used to determine net periodic postretirement benefit cost:

	2006	2005
Weighted-average discount rate	5.0%	6.25%

For measurement purposes, an 11% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2006. The rate was assumed to decrease gradually to 5% by 2014 and remain at that level thereafter. The health care cost trend rate assumption has an effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rate one-percentage-point each year would increase the accumulated postretirement benefit obligation as of September 30, 2006 by $19 and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for 2006 by $1.

As of December 31, 2004, health care postretirement benefits have been eliminated for all active employees of the Hospital who have not attained age 55 and completed five years of consecutive service.

New Accounting Pronouncement Re: Pension and Other Postretirement Benefit Plans

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans". FASB Statement No. 158, which is an amendment of FASB Statements No. 87, 88, 106, and 132R, requires an employer to recognize in its statement of financial position an asset for a benefit plan's overfunded status or a liability for a plan's underfunded status, with a corresponding increase or decrease in unrestricted net assets. The funded-status amount will be measured as the difference between the fair value of plan assets and the benefit obligation including all actuarial gains and losses and prior service cost.

The requirement to recognize the funded status of Lifespan's benefit plans is effective as of September 30, 2007. Based on September 30, 2006 funded-status amounts for the Hospital's portion of the Lifespan Corporation Retirement Plan as well as the Hospital's postretirement health care program, the Hospital would record increases in unrestricted net assets of $1,148 and $1,182, respectively, in 2007.

(Continued)

(In thousands)

(8) Patient Service Revenue and Related Reimbursement

A major portion of the Hospital's revenue is received from third-party payors. The following is an approximate percentage breakdown of gross patient service revenue by payor type for the years ended September 30:

	2006	2005
Medicare and Senior Care	49%	50%
Blue Cross	22	22
Medicaid and Rite Care	7	7
Managed care	15	14
Commercial, self-pay and other	7	7
	100%	100%

The Hospital grants credit to patients, most of whom are local residents. The Hospital generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross, managed care, and commercial insurance policies).

Cost reports filed annually with third-party payors are subject to audit prior to final settlement. The 2006 cost reports have not been filed and, therefore, not settled with either Medicare or Medicaid. In addition, the Medicare and Medicaid cost reports for 2004 and 2005 have not been settled.

Regulations in effect require annual settlements based upon cost reports filed by the Hospital. These settlements are estimated and recorded in the accompanying financial statements. Changes in these estimates are reflected in the financial statements in the year in which they occur. Net patient service revenue in the accompanying statements of operations and changes in net assets was increased by $1,583 and $164 in 2006 and 2005, respectively, to reflect changes in the estimated settlements for certain prior years.

Revenues from Medicare and Medicaid programs accounted for approximately 49% and 7%, respectively, of the Hospital's gross patient service revenue for the year ended September 30, 2006. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations. Compliance with laws and regulations can be subject to future government review and interpretation as well as significant regulatory action; failure to comply with such laws and regulations can result in fines, penalties and exclusion from Medicare and Medicaid programs.

(Continued)

(In thousands)

(9) Income Tax Status

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from Federal income taxes pursuant to Section 501(a) of the Code.

(10) Long-Term Debt

Long-term debt consists of the following at September 30:

	2006	2005
Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2009 through 2032 in annual amounts ranging from $2,355 to $15,020 at rates ranging from 4% to 5% (2006A Series—Lifespan Obligated Group—the Hospital and RIH)	$ 38,811	$ —
Hospital Financing Revenue fixed rate serial and term bonds due May 15, 2007 through 2026 in annual amounts ranging from $5,255 to $14,705 at rates ranging from 5.2% to 5.75% (1996 Series—Lifespan Obligated Group—the Hospital and RIH)	10,673	33,139
Hospital Financing Revenue fixed rate serial and term bonds due August 15, 2007 through 2012 in annual amounts ranging from $1,210 to $1,595 at rates ranging from 5% to 6.375% (2002 Series—Lifespan Obligated Group—the Hospital and RIH)	2,085	18,701
Unamortized premium – 2006A Series	1,827	—
Unamortized discount – 1996 and 2002 Series	(34)	(328)
	53,362	51,512
Less current portion	1,222	1,157
Long-term debt, excluding current portion	$ 52,140	$ 50,355

The estimated fair value of the Hospital's long-term debt at September 30, 2006 amounts to $54,407 and is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements.

(Continued)

(In thousands)

(10) Long-Term Debt (continued)

On February 14, 2006, Rhode Island Health and Educational Building Corporation (RIHEBC) issued, on behalf of the Lifespan Obligated Group, which consists of the Hospital and RIH, $192,135 of tax-exempt bonds (the 2006A Bonds) for the purpose of advance refunding $123,405 and $65,315 of the Lifespan Obligated Group's 1996 Bonds and 2002 Bonds, respectively. The advance refundings are allocated as follows:

	1996 Bonds	2002 Bonds
The Hospital	$ 21,596	$ 16,329
RIH	101,809	48,986
Total	$ 123,405	$ 65,315

A total of $195,087 of the net proceeds of the 2006 bond issue and $8,166 of the refunded bonds' unspent debt service funds was deposited into trust funds for the purpose of these refundings. TMH's portion of these deposits amounted to $41,319. The principal balance outstanding on the 1996 and 2002 refunded bonds, which are considered extinguished, was $123,405 and $65,315, respectively, at September 30, 2006. The trusts are held by an independent trustee and are invested in obligations of the United States Government which mature and bear interest in such amounts and at such times as will be sufficient to pay the principal and interest as it comes due on the 1996 and 2002 refunded bonds.

The above outstanding 2006 Hospital Financing Revenue Bonds (Lifespan Obligated Group—the Hospital and RIH) are secured by a pledge of the gross receipts of the Hospital and RIH and by mortgage liens on the Hospital's and RIH's real property and all buildings, structures and improvements thereon. The Hospital and RIH are jointly and severally liable for repayment of the 2006A Bonds, $38,811 and $153,324 of which has been recorded directly by the Hospital and RIH, respectively. Payment of the principal and interest on the 2006A Bonds when due is guaranteed by a financial guaranty insurance policy issued by Financial Security Assurance, Inc.

The above advance refunding resulted in a nonoperating loss in 2006 of $15,913 of which $3,673 and $12,240 was recorded by the Hospital and RIH, respectively.

On July 9, 2002, RIHEBC issued, on behalf of the Lifespan Obligated Group, $78,000 of tax-exempt bonds (the 2002 Bonds) to finance routine capital expenditures of the Hospital and RIH, renovations of the RIH emergency department and construction and equipping of a cancer center on the campus of RIH.

(10) Long-Term Debt (continued)

The above outstanding 2002 Hospital Financing Revenue Bonds (Lifespan Obligated Group—the Hospital and RIH) are secured by mortgage liens on the Hospital's and RIH's real property and all buildings, structures and improvements thereon. The Hospital and RIH are jointly and severally liable for repayment of the outstanding 2002 Bonds, $2,085 and $6,255 of which has been recorded directly by the Hospital and RIH, respectively.

On December 1, 1996, RIHEBC issued, on behalf of the Lifespan Obligated Group, $214,585 of tax-exempt bonds (the 1996 Bonds) to finance portions of Lifespan's, the Hospital's and RIH's 1996, 1997, 1998 and 1999 expenditures for routine capital equipment and facility renovation/replacement, and to advance refund $8,455 of the Hospital's 1989 Series A bonds, $1,900 of the Hospital's 1992 Series A bonds and $10,065 of the Hospital's 1992 Series B bonds. A total of $20,580 of the net proceeds from the 1996 bond issue and $1,004 of the refunded bonds' unspent debt service funds was deposited into trust funds for the purpose of these refundings. The principal balance outstanding on the Hospital's refunded bonds, which are considered extinguished, was $14,255 at September 30, 2006. The trusts are held by an independent trustee and are invested in obligations of the United States Government which mature and bear interest in such amounts and at such times as will be sufficient to pay the principal and interest as it comes due on the Hospital's refunded bonds.

The above outstanding 1996 Hospital Financing Revenue Bonds (Lifespan Obligated Group—the Hospital and RIH) are secured by a pledge of the gross receipts of the Hospital and RIH. The Hospital and RIH are jointly and severally liable for repayment of the outstanding 1996 Bonds, $10,673 and $50,317 of which has been recorded directly by the Hospital and RIH, respectively. Payment of the principal and interest on the 1996 Bonds when due is guaranteed by a financial guaranty insurance policy issued by MBIA Insurance Corporation.

Under the terms of the 2006, 2002 and 1996 Bonds, the Hospital and RIH are required to satisfy certain measures of financial performance as long as the bonds are outstanding. At September 30, 2006, the Hospital and RIH were in compliance with all covenants of the bonds.

The Hospital's aggregate maturities of long-term debt for the five fiscal years ending in September 2011 are as follows: 2007, $1,222; 2008, $417; 2009, $914; 2010, $1,798 and 2011, $1,879.

Agreements underlying the Hospital Financing Revenue Bonds require that the Lifespan Obligated Group maintain certain trustee-held funds, included with assets limited as to use in the statements of financial position, as follows:

Bond Fund — The Lifespan Obligated Group is required to make quarterly deposits to the trustee sufficient to provide sinking funds for the payment of principal and interest to bondholders when due.

(In thousands)

(10) Long-Term Debt (continued)

Debt Service Reserve Fund — The Lifespan Obligated Group is required to apply monies in the Debt Service Reserve Fund to remedy deficiencies in the 2002 Bond Fund, if any.

The balances of these trustee-held funds at September 30 are summarized as follows:

	2006	2005
Bond Funds	$ 7	$ 717
Debt Service Reserve Fund – 2002 Series	442	1,487
Total	$ 449	$ 2,204

During the years ended September 30, 2006 and 2005, the Hospital's interest expense was $2,715 and $3,083, respectively. Interest paid was $2,681 and $3,090 during the years ended September 30, 2006 and 2005, respectively.

On September 12, 2006, the Board of Directors of Lifespan Corporation, acting as the sole member of each of The Miriam Hospital Foundation and Rhode Island Hospital Foundation (the Foundations), adopted resolutions authorizing the Foundations to become members of the Lifespan Obligated Group. The Boards of Trustees of each of the Foundations, as well as the existing members of the Lifespan Obligated Group, the Hospital and RIH, previously authorized related resolutions. The effective date for such change is October 1, 2006.

(11) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30:

	2006	2005
General health care service activities	$ 4,048	$ 3,515
Research	13,286	10,431
Interest in net assets of The Miriam Hospital Foundation	8,181	6,434
Total	$ 25,515	$ 20,380

(Continued)

(In thousands)

(11) Temporarily and Permanently Restricted Net Assets (continued)

Permanently restricted net assets are restricted in perpetuity at September 30 and consist of the following:

	2006	2005
Interest in net assets of The Miriam Hospital Foundation	$ 6,193	$ 5,814

(12) Leases

The Hospital leases building space and equipment under various noncancelable operating lease agreements. Future minimum lease payments, by year and in the aggregate, under noncancelable operating leases with terms of one year or more consist of the following at September 30, 2006:

Year Ending September 30:	Amount
2007	$ 3,430
2008	3,229
2009	3,189
2010	3,122
2011	2,969
Total minimum lease payments	$ 15,939

Rental expense, including rentals under leases with terms of less than one year, for the years ended September 30, 2006 and 2005 was $4,827 and $4,575, respectively.

(13) Concentrations of Credit Risk

Financial instruments which potentially subject the Hospital to concentrations of credit risk consist primarily of accounts receivable and certain investments. The risk associated with temporary cash investments is mitigated by the fact that the investments are placed with what management believes are high credit quality financial institutions. Investments, which include government and agency obligations, stocks, and corporate bonds are not concentrated in any corporation or industry.

The Hospital receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payors, including Medicare, Blue Cross, Medicaid, and various managed care entities. The Hospital has not historically incurred any significant concentrated credit losses in the normal course of business.

(Continued)

(14) Malpractice and Other Litigation

Professional Liability/Medical Malpractice

Professional liability/medical malpractice coverage for the Hospital is supplied on a claims-made basis by Rhode Island Sound Enterprises Insurance Co., Ltd. (RISE), Lifespan's affiliated captive insurance company, which underwrites the medical malpractice risk of the Hospital. The adequacy of the coverage provided and the funding levels are reviewed annually by independent actuaries and consultants. The professional liability insurance provided by RISE has liability limits of $4,000 per claim with no annual aggregate. RISE provides a second layer of coverage which has limits of an additional $2,000 per claim with a $2,000 annual aggregate. In addition, commercial umbrella excess insurance has been obtained by Lifespan to increase the professional liability limits to $22,000 per claim.

The Hospital has been named as a defendant in a number of pending actions seeking damages for alleged medical malpractice. In the opinion of management, any liability and legal defense costs resulting from these actions will be within the limits of the Hospital's malpractice insurance coverage provided by RISE and/or commercial excess carriers.

General Liability

General liability coverage is provided to the Hospital by RISE amounting to $4,000 per claim and $4,000 in the annual aggregate. Commercial excess liability insurance has been obtained by Lifespan which provides aggregate general liability coverage of $80,000.

Workers' Compensation

The Hospital has incurred a number of workers' compensation claims and, in the opinion of management, the liability of the Hospital will be within the limits of the assets of Lifespan's workers' compensation self-insurance trust fund.

Other Litigation

The Hospital is also involved in a number of miscellaneous suits and general liability suits arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations.

(In thousands)

(15) Related-Party Transactions (continued)

The Hospital was charged a management fee by Lifespan of $20,940 and $19,993 in 2006 and 2005, respectively, representing approximately 22% of Lifespan's operating expenses in each year. Lifespan provides information services, human resources, financial, and various other support services to the Hospital.

Included in other receivables and other accrued expenses are the following significant amounts due from (to) certain related entities at September 30:

	2006	2005
Other receivables:		
Newport Hospital	$ 157	$ 90
Other accrued expenses:		
Lifespan	$ (315)	$ (294)
RIH	(692)	(120)
Total	$ (1,007)	$ (414)

During the years ended September 30, 2006 and 2005, the Hospital received temporarily restricted net asset transfers from The Miriam Hospital Foundation (the Foundation) amounting to $3,626 and $4,142, respectively. In addition, the Hospital received grants from the Foundation amounting to $500 in both 2006 and 2005 in support of the Hospital's research activities. Such grants are included in other revenue.

(In thousands)

(15) Related-Party Transactions (continued)

The Foundation, whose sole corporate member is Lifespan Corporation, was established to engage in philanthropic activities to support the mission and purposes of Lifespan and the Hospital. Funds are distributed to the Hospital when purpose restrictions stipulated by donors are accomplished, or as determined by the Boards of Trustees of the Hospital and the Foundation. A summary of the Foundation's assets, liabilities, net assets, results of operations, and changes in net assets follows. The Hospital's interest in the net assets of the Foundation is reported as a noncurrent asset in the statements of financial position.

	2006	2005
Assets, principally assets limited as to use	$ 52,986	$ 48,992
Liabilities	$ 1,084	$ 938
Unrestricted net assets	37,528	35,806
Temporarily restricted net assets	8,181	6,434
Permanently restricted net assets	6,193	5,814
Total liabilities and net assets	$ 52,986	$ 48,992
Total unrestricted revenues, gains and other support	$ 3,586	$ 2,833
Total expenses	1,525	811
Excess of revenues over expenses	2,061	2,022
Other (decreases) increases in unrestricted net assets	(339)	1,768
Unrestricted net assets, beginning of year	35,806	32,016
Unrestricted net assets, end of year	$ 37,528	$ 35,806
Increase (decrease) in temporarily restricted net assets	$ 1,747	$ (1,159)
Temporarily restricted net assets, beginning of year	6,434	7,593
Temporarily restricted net assets, end of year	$ 8,181	$ 6,434
Increase in permanently restricted net assets	$ 379	$ 380
Permanently restricted net assets, beginning of year	5,814	5,434
Permanently restricted net assets, end of year	$ 6,193	$ 5,814

There are no amounts payable from the Foundation to the Hospital at the end of 2006 and 2005.

(In thousands)

(16) Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows for the years ended September 30:

	2006	2005
Health care services	$ 229,566	$ 224,345
Research	23,542	25,366
General and administrative:		
Depreciation and amortization	8,057	7,978
Interest	2,715	3,083
License fees	8,115	6,623
Other	27,520	25,680
Total general and administrative	46,407	43,364
	$ 299,515	$ 293,075